ADFA

ARKANSAS DEVELOPMENT FINANCE AUTHORITY
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July 29, 2005

MANDATORY NOTICE
as required by
IRS Revenue Procedure 2005-37
TO OWNERS OF BUILDINGS RECEIVING FEDERAL LOW-INCOME TAX CREDITS

All owners of building(s) receiving Federal Low-Income Tax Credits (LIHTC) are subject to the various policies, procedures, and rulings issued by the Internal Revenue Service (IRS) in its interpretation of Section 42 of the Internal Revenue Code, 26 U.S.C. § 42 (Section 42).

THIS IS A MANDATORY NOTICE REQUIRED BY IRS REVENUE PROCEDURE 2005-37. LIHTC BUILDING OWNERS MUST IMMEDIATELY READ THIS NOTICE AND THE FOLLOWING COPY OF IRS REV. PROC. 2005-37 IN THEIR ENTIRETY TO ENSURE AVAILABILTY OF LOW-INCOME TAX CREDIT FOR YOUR BUILDINGS FOR CURRENT AND PAST YEARS.

BACKGROUND

On August 30, 2004, the IRS, through Revenue Ruling 2004-82, interpreted Section 42(h)(6)(B)(i) to state that no tax credit will be allowed for any building for any tax year unless the Land Use Restriction Agreement (LURA) covering the building included provisions prohibiting:

(1) eviction or termination of the tenancy of an existing low-income unit tenant other than for good cause throughout the 30-year extended use period; and
(2) any increase in the gross rent for any low-income unit other than as permitted by Section 42 throughout the 30-year extended use period.

(These two provisions are collectively referred to in this Notice as the "Prohibiting Provisions.")

The IRS determined that these provisions were required to be included, beginning in 1990, as a result of the enactment of Section 42(h)(6)(B)(i) in the Omnibus Budget Reconciliation Act of 1990.

The IRS required all state allocating agencies, including ADFA, to review existing LURAs to determine whether the "Prohibiting Provisions" are included. The IRS advised that, if it was determined that the prohibiting provisions were not included, a valid LURA containing the "Prohibiting Provisions" had to be put into effect within 1 year of the determination to ensure tax credit availability for all of the building(s) tax years, current and previous.

Following a review of the various forms of LURAs utilized by taxpayers in Arkansas since 1990, ADFA staff has found that the "Prohibited Provisions" were not included. Because of this review, ADFA staff drafted a new LURA form containing the "Prohibiting Provisions." This form is available on ADFA's website: www.arkansas.gov/adfa. (Click on "Publications and Forms" then scroll down to "Multi-Family" then select items 1 and 2 under "Multi-Family Housing Documentation.")

"SAFE HARBOR" PROVIDED BY IRS REV. PROC. 2005-37

On June 21, 2005, the IRS issued Revenue Procedure 2005-37. It provides a "safe harbor" for LURAs recorded prior to January 1, 2006, from the requirement that a new LURA be recorded containing the "Prohibiting Provisions," so long as the following criteria are met:

1. LURAs entered into prior to January 1, 2006, contain general language requiring building owners to comply with the requirements of Section 42 ("catch-all" language);

2. Allocating agencies notify building owners in writing on or before December 31, 2005, that the catch-all language prohibits the owner from evicting or terminating the tenancy of an existing tenant of any low-income (other than for good cause) throughout the entire 30-year extended use period;

3. Allocating agencies notify building owners in writing on or before December 31, 2005, that the catch-all language prohibits the owner from making an increase in the gross rent with respect to a low-income unit not otherwise permitted by Section 42 throughout the entire 30-year extended use period; and

4. The owner, as part of its certification under Section 1.42-5(c)(1)(xi), certifies annually that for the preceding 12-month period no tenants in low-income units were evicted or had their tenancies terminated other than for good cause and that no tenants had an increase in the gross rent with respect to a low-income unit not otherwise permitted under Section 42.

- If the owner fails to make the certification stated above or the Authority learns that the owner has either evicted a tenant or terminated a tenancy for other than good cause or increased the gross rent not permitted under Section 42, the Authority must report the noncompliance to the IRS.

IRS Rev. Proc. 2005-37 provides there is NO "safe harbor" for any LURA recorded prior to January 1, 2006, that does not have the "catch-all" language. Any LURA that does not have the "catch-all" language must be amended, no later than December 31, 2005, to clearly state the "Prohibiting Provisions."

ACTION REQUIRED TO COMPLY WITH IRS REV. PROC. 2005-37 AND PROTECT YOUR LOW-INCOME TAX CREDIT AVAILABILITY

The LURA forms used and recorded by Arkansas owner/taxpayers prior to January 1, 2006, appear to contain the "catch-all" language. An example of that language follows:

> The Owner covenants that it will not knowingly take or permit any action which would result in violation of the requirements of Section 42 of the code and applicable regulations of this Agreement. Moreover, Owner covenants to take any lawful action (including amendment of this Agreement as may be necessary, in the opinion of the Authority) to comply fully with the Code and with all applicable rules, ruling, policies, procedures, regulations or other official statements promulgated or proposed by the United States Department of the Treasury or the Internal Revenue Service or HUD from time to time pertaining to Owner's obligations under Section 42 of the Code and affecting the Project.

Although it appears that LURAs, recorded by Arkansas owner/taxpayers prior to January 1, 2006, contain the "catch-all" language **YOU must review all recorded LURAs that apply to any building in any development, which is owned by you to ensure the "catch-all" language is present.**

If your LURAs contain the "catch-all" language you are not required to amend the LURAs, however:

- You are notified the "catch-all" language prohibits you from:
  1. evicting or terminating the tenancy of an existing tenant of any low-income (other than for good cause) throughout the entire 30-year extended use period; and
  2. making an increase in the gross rent with respect to a low-income unit not otherwise permitted by Section 42 throughout the entire 30-year extended use period.

- You are also notified that, as part of your certification under Section 1.42-5(c)(1)(xi), you must annually certify that, for the preceding 12-month period:
    1. no tenants in low-income units were evicted or had their tenancies terminated other than for good cause; and
    2. that no tenants had an increase in the gross rent with respect to a low-income unit not otherwise permitted under Section 42.

If your LURAs do NOT contain the "catch-all" language or if you have not recorded a LURA:

- You **must** amend your LURAs or file a LURA if you have no LURA, **no later than December 31, 2005**, which includes the "Prohibited Provisions." ADFA staff has drafted a new LURA form, which contains the "Prohibited Provisions" for your use. It is available on ADFA's website: www.arkansas.gov/adfa. (Click on "Publications and Forms" then scroll down to "Multi-Family" and select items 1 and 2 under "Multi-Family Housing Documentation.")

- You are notified that, as part of your certification under Section 1.42-5(c)(1)(xi), you must annually certify that, for the preceding 12-month period:
    1. no tenants in low-income units were evicted or had their tenancies terminated other than for good cause; and
    2. that no tenants had an increase in the gross rent with respect to a low-income unit not otherwise permitted under Section 42.

It is imperative that you comply with the provisions of IRS Rev. Proc. 2005-37 to protect your investment in the federal low-income housing tax credit program. ADFA greatly appreciates your participation in this program and is intent on providing you with any assistance it can to ensure compliance with all IRS requirements.

You are encouraged to contact Bruce H. Bokony, Multi-Family Housing Programs Manager, (501) 682-5927 with any question you might have regarding this Notice.

Part III

Administrative, Procedural, and Miscellaneous

26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.
(Also Part I, § 42; 1.42-5.)

Rev. Proc. 2005-37

SECTION 1. PURPOSE

This revenue procedure establishes a safe harbor under which housing credit agencies and project owners may meet the requirements of § 42(h)(6)(B)(i) of the Internal Revenue Code as described in Q&A-5 of Rev. Rul. 2004-82, 2004-35 I.R.B. 350, concerning extended low-income housing commitments (commitments).

SECTION 2. BACKGROUND

Section 42(a) provides for a credit for investment in qualified low-income buildings (as defined in § 42(c)(2)). Under § 42(i)(3)(A), low-income units in a building must be occupied by individuals who meet the income limitation applicable under § 42(g)(1) to the project of which the building is a part. The building owner must elect under § 42(g)(1) to rent a percentage of the residential units to individuals whose income is 50 percent or less of area median gross income or 60 percent or less of area median gross income.

Section 42(h)(6)(A) provides that no credit will be allowed with respect to any building for the taxable year unless a commitment (as defined in § 42(h)(6)(B)) is in effect as of the end of the taxable year.

Section 42(h)(6)(B)(i) requires commitments to include the prohibitions against the actions described in subclauses (I) and (II) of § 42(h)(6)(E)(ii) during the extended use period, that is, prohibitions against eviction or termination of tenancy of an existing tenant of any low-income unit (other than for good cause) and any increase in the gross rent with respect to a low-income unit not otherwise permitted by § 42, applicable throughout the entire commitment period.

Section 42(h)(6)(B)(ii) provides that a commitment must allow individuals who meet the income limitation applicable to the building under § 42(g) (whether prospective, present, or former occupants of the building) the right to enforce in any state court the prohibitions of § 42(h)(6)(B)(i).

Section 42(h)(6)(J) provides that if, during a taxable year, there is a determination that a commitment was not in effect as of the beginning of the taxable year, the determination shall not apply to any period before the year and subparagraph (A) shall be applied without regard to the determination if the failure is corrected within 1 year from the date of determination.

Section 1.42-5(c)(1)(xi) of the Income Tax Regulations provides that a housing credit agency must require the owner of a low-income housing project to certify at least annually to the housing credit agency that, for the preceding 12-month period, a commitment as described in § 42(h)(6) was in effect (for buildings subject to § 7108(c)(1) of the Omnibus Budget Reconciliation Act of 1989, 1990-1 C.B. 210),

including the requirement under § 42(h)(6)(B)(iv) that an owner cannot refuse to lease a unit in the project to an applicant because the applicant holds a voucher or certificate of eligibility under section 8 of the United States Housing Act of 1937, 42 U.S.C. 1437f (for buildings subject to § 13142(b)(4) of the Omnibus Budget Reconciliation Act of 1993, 1993-3 C.B. 1).

On August 30, 2004, the Service ruled in Q&A-5 of Rev. Rul. 2004-82 that § 42(h)(6)(B)(i) requires commitments to include the prohibitions against the actions described in subclauses (I) and (II) of § 42(h)(6)(E)(ii) during the extended use period, that is, prohibitions against eviction or termination of tenancy of an existing tenant of any low-income unit (other than for good cause) and any increase in the gross rent with respect to a low-income unit not otherwise permitted by § 42, applicable throughout the entire commitment period. This requirement for commitments extends back to the effective date of § 42(h)(6)(B)(i). See § 11701(a)(7)(A) of the Omnibus Budget Reconciliation Act of 1990, 1991-2 C.B. 481, 531.

Q&A-5 provided that if it is determined by the end of a taxable year that a taxpayer's commitment does not meet the requirements for a commitment under § 42(h)(6)(B) (for example, it does not provide no-cause eviction protection for the tenants of low-income units throughout the extended use period), the low income housing credit is not allowable with respect to the building for the taxable year, or any prior taxable year. However, if the failure to have a valid commitment in effect is corrected within 1 year from the date of the determination, the determination will not apply to the current year of the credit period or any prior year.

Q&A-5 required each Agency to review its existing commitments by December 31, 2004, to ensure that the no-cause eviction protection and the prohibition against improper increases in gross rent apply throughout the extended use period. If during that review, an Agency determined that a commitment did not comply with these requirements, the 1-year period described under § 42(h)(6)(J) will commence on the date of that determination.

SECTION 3. SAFE HARBOR

.01 The Service has determined that Agencies may satisfy the review requirements under Q&A-5 for commitments entered into before January 1, 2006, under § 42(h)(6)(B)(i) in the following manner:

(1) Commitments entered into before January 1, 2006, that contain general language requiring building owners to comply with the requirements of § 42 (catch-all language) satisfy the requirements under Q&A-5, if:

(a) Agencies notify building owners in writing on or before December 31, 2005, that consistent with the interpretation in Q&A-5, the catch-all language prohibits the owner from evicting or terminating the tenancy of an existing tenant of any low-income unit (other than for good cause) throughout the entire commitment period. Further, Agencies must notify building owners that the catch-all language prohibits the owner from making an increase in the gross rent with respect to a low-income unit not otherwise permitted by § 42 throughout the entire commitment period;

(b) The owner must, as part of its certification under § 1.42-5(c)(1)(xi), certify annually that for the preceding 12-month period no tenants in low-income units were evicted or had their tenancies terminated other than for good cause and that no tenants

had an increase in the gross rent with respect to a low-income unit not otherwise permitted under § 42;

(c) If the owner fails to make the certifications in (b) above or the Agency learns that the owner has evicted tenants in low-income units or terminated their tenancies other than for good cause or has increased the gross rent of a tenant with respect to a low-income unit not otherwise permitted under § 42, the Agency shall report the owner to the Internal Revenue Service using Form 8823, Low-Income Housing Credit Agencies Report of Noncompliance or Building Disposition; and

(d) Section 3.02 shall also apply to any amendment to any commitment containing catch-all language if the amendment is executed after December 31, 2005.

(2) Commitments entered into before January 1, 2006, that do not contain specific language on the § 42(h)(6)(B)(i) prohibition against the actions described in subclauses (I) and (II) of § 42(h)(6)(E)(ii) or catch-all language do not satisfy the requirements of Q&A-5 and must be amended to clearly provide for the § 42(h)(6)(B)(i) prohibition against the actions described in subclauses (I) and (II) of § 42(h)(6)(E)(ii) by December 31, 2005.

.02 The Service has determined that Agencies may satisfy the review requirements under Q&A-5 for commitments executed after December 31, 2005, under § 42(h)(6)(B)(i) in the following manner:

(1) Commitments executed after December 31, 2005, must clearly provide for the § 42(h)(6)(B)(i) prohibition against the actions described in subclauses (I) and (II) of § 42(h)(6)(E)(ii);

(2) The owner must, as part of its certifications under § 1.42-5(c)(1)(xi), certify annually that for the preceding 12-month period no tenants in low-income units were evicted or had their tenancies terminated other than for good cause and that no tenants had an increase in the gross rent with respect to a low-income unit not otherwise permitted under § 42; and

(3) If the owner fails to make the certifications in (2) above or the Agency learns that the owner has evicted tenants in low-income units or terminated their tenancies other than for good cause or has increased the gross rent of a tenant with respect to a low-income unit not otherwise permitted under § 42, the Agency shall report the owner to the Internal Revenue Service using Form 8823, Low-Income Housing Credit Agencies Report of Noncompliance or Building Disposition.

EFFECTIVE DATE

This revenue procedure is effective on June 21, 2005, the date this revenue procedure was released to the tax services.

DRAFTING INFORMATION

The principal author of this revenue procedure is Jack Malgeri of the Office of the Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue procedure contact Mr. Malgeri on (202) 622-3040 (not a toll-free call).